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INTELLIGENCE MEMORANDUM

THE ECONOMIC IMPORTANCE OF THE ABOLITION
OF MULTILATERAL DIFFERENTIAL TRADE CONTROLS
AGAINST COMMUNIST CHINA

CIA/RR IM-452

17 June 1957

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CONTENTS

| | <u>Page</u> |
|--|-------------|
| Summary | 1 |
| 1. Background | 2 |
| 25X6A a. CHINCOM Negotiations | 2 |
| [REDACTED] | |
| 2. Levels of Sino - Free World Trade | 3 |
| a. General | 3 |
| b. Trade with CHINCOM Countries | 4 |
| 3. Prospects for Sino - Free World Trade | 5 |
| a. Availability of Foreign Exchange | 5 |
| b. Reorientation of Trade | 6 |
| 4. Effects of the Continuation of Unilateral Controls by the US | 7 |

Table

| | |
|---|---|
| Recorded Sino - Free World Trade, 1954-56 | 4 |
|---|---|

S-E-C-R-E-T

CIA/RR IM-452
(ORR Project 42.1969)

S-E-C-R-E-T

THE ECONOMIC IMPORTANCE OF THE ABOLITION
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AGAINST COMMUNIST CHINA*

Summary

The trade of Communist China with the Free World has grown at a rapid rate over the past 3 years. In view of its export surplus in trade with the Free World and its substantial holdings of Free World currencies, China appears capable of continuing this growth.

Abolition of multilateral differential trade controls against Communist China would tend to facilitate the expansion of its trade with the Free World, without necessarily resulting in a substantial reorientation of its total foreign trade. It is not presently possible to predict the level to which controls might fall. By making various assumptions as to what the subsequent level of controls will be, however, it is possible to estimate the potential gains to China as follows:

1. The reduction of CHINCOM** controls to COCOM** levels could effect price and transport savings of about US \$35 million*** annually.
2. The removal of ancillary shipping controls permitting the carriage of refined petroleum products by Free World flag vessels could effect additional savings of as much as \$30 million.
3. The lowering by the US of its unilateral controls against Communist China to those prevailing against the rest of the Soviet Bloc might open unique opportunities for markets and might permit dollar remittances totaling \$75 million annually.

* The estimates and conclusions contained in this memorandum represent the best judgment of ORR as of 14 June 1957.

** Member nations of the China Committee on Export Controls (CHINCOM) and the Coordinating Committee on Export Controls (COCOM) are Belgium, Canada, Denmark, France, West Germany, Greece, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, Turkey, the UK, and the US.

*** Dollar values are given in terms of US dollars throughout this report.

S-E-C-R-E-T

S-E-C-R-E-T

4. The relaxation of CHINCOM controls could prompt Communist China to drop present restrictions on trade with Japan, permitting a possible increase in Chinese exchange earnings from trade with that country of as much as \$50 million annually.

Relaxation of CHINCOM controls could, therefore, result in an increase of Chinese Communist imports from the Free World of between \$35 million and \$190 million annually. Chinese exports to the Free World would probably rise by a somewhat smaller amount.

1. Background.

Since 1954, pressures in CHINCOM for the modification of China trade controls have steadily increased. These pressures, generated in large part by commercial trading interests and reflected in government positions, have come primarily from the UK, Japan, France, and West Germany. These four countries and Norway, Denmark, and Portugal have also objected to the differential treatment of Communist China on the basis of principle, holding that trade controls on Communist China should be treated under the same criteria as the European Soviet Bloc. The US policy to date has been one of a unilateral total embargo on trade with China and of participation in CHINCOM to effect the best possible multilateral restrictions on such trade. US economic defense policy in March 1957 implicitly recognized these pressures and authorized a US course of action designed to maintain the maximum effective control structure.

a. CHINCOM Negotiations.

On 7 May 1957, France made a proposal in the CHINCOM forum which would have had the effect of eliminating the China differential in from 6 months to 1 year. On this same date the US, carrying out its current policy, proposed a revision of China trade controls which eliminated a large number of items from control and simultaneously called for tightened controls on the remaining items. Neither proposal received the unanimous support of CHINCOM. During the period 7 to 27 May, efforts were made to negotiate an acceptable compromise within CHINCOM, and on 21 May, after several compromise steps by the US, an alternative proposal was offered by a small group of delegates. (The US and the UK were not in this group.) The US, in the interests

- 2 -

S-E-C-R-E-T

S-E-C-R-E-T

of reaching a unanimous agreement, supported the compromise proposal on 23 May as did a majority of the participating countries. The UK, Denmark, Norway, and Portugal rejected the compromise but did not withdraw from further negotiations. (Japan and Canada "reserved" their positions.)

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2. Levels of Sino - Free World Trade.

a. General.

The trade of Communist China with the Free World has steadily increased over the past 3 years. Preliminary estimates based on Free World sources place the value of total Sino - Free World trade in 1956 at nearly \$1 billion compared with \$621 million in 1954. Data on recorded Sino - Free World trade, which account for about 90 to 95 percent of the estimated total of such trade, indicate that the greater part of the increase in total trade in 1956 was caused by an increase of \$112 million in Chinese exports to the Free World. Over the same period, Chinese imports from the Free World increased by \$87 million. Recorded Sino - Free World trade in 1954-56 is shown in the table.*

As in 1955, Communist China once again in 1956 had a marked surplus in its balance of recorded trade with the Free World. The addition of estimated unrecorded imports from the Free World of \$50 million, \$76 million, and \$50 million for 1954, 1955, and 1956, respectively, wiped out the apparent export surplus of China for 1954 and considerably reduced that for 1955. The actual export surplus of China for 1956 remained large -- its exports to the Free World exceeded imports about 17 percent.

* The table follows on p. 4.

- 3 -

S-E-C-R-E-T

S-E-C-R-E-T

Table

Recorded Sino - Free World Trade a/
1954-56

| | Million US \$ | | |
|-------------------|---------------|-------------|----------------|
| | <u>1954</u> | <u>1955</u> | <u>1956 b/</u> |
| Imports from | | | |
| Free World | 273 | 321 | 408 |
| CHINCOM countries | 80 | 110 | 202 |
| Exports to | | | |
| Free World | 298 | 423 | 535 |
| CHINCOM countries | 113 | 175 | 208 |

- a. Data adjusted according to established EIC methodology to reflect c.i.f. values for imports and f.o.b. values for exports.
b. Preliminary estimates.

b. Trade with CHINCOM Countries.

The recorded trade of Communist China with the 15 CHINCOM countries accounted for less than 45 percent of Sino - Free World trade during the past 3 years (see the table). Trade with European CHINCOM nations amounted to less than 30 percent of the total. In 1956, however, the CHINCOM countries more than accounted for the entire increase in Chinese imports from the Free World. This situation was due to a more liberal interpretation and a greatly increased utilization of the exceptions procedures* in the latter half of the

* Document No. 471 exceptions procedures apply to IL-I, IL-II, and most IL-III items and require prior consultation and an adequate quid pro quo justification for any export of these items.

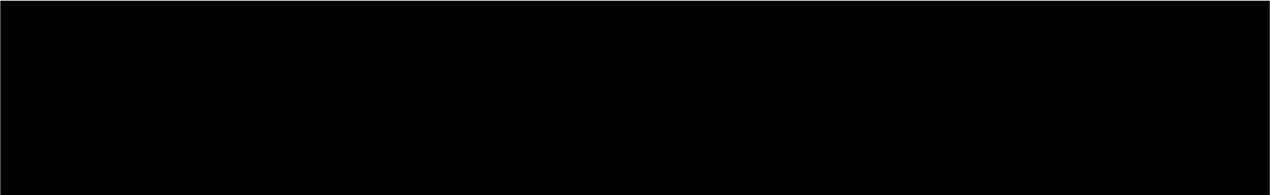
Document No. 782 exceptions procedures apply to a small number of IL-III items and the China Special List and require only ex poste facto notification. These were the procedures most freely used during the latter half of 1956, when exceptions rose sharply.

For further details on exceptions procedures, see COCOM Document No. 471 of 28 January 1952 and COCOM Document No. 782 of 10 June 1952.

S-E-C-R-E-T

S-E-C-R-E-T

year, with the result that exceptions totaled \$79 million for the year. The most notable effect of the increased use of the exceptions procedures was that the value of the recorded Chinese imports of metals and machinery doubled, reaching an estimated value of \$40 million.



In each of the past 3 years, the recorded imports of CHINCOM countries from Communist China have exceeded their exports to that country. Because the major portion of the unrecorded Chinese imports from the Free World is believed to have originated in CHINCOM countries, however, it seems probable that Sino-CHINCOM trade has fluctuated between a near balance and a deficit on the side of China. Japan, the major Free World outlet for Chinese products, maintained her imports in 1956 at somewhat over \$80 million. The most notable change was the \$10 million increase in imports by Germany, which boosted that country's Chinese imports above the \$55 million level.

3. Prospects for Sino - Free World Trade.

a. Availability of Foreign Exchange.

It is estimated that accumulated surpluses in its balance of trade with the Free World plus estimated annual remittances from overseas Chinese of \$50 million may have left Communist China at the beginning of 1957 with Free World currency holdings worth roughly \$300 million, of which nearly half is believed to be in transferable sterling. Chinese sterling balances, which were estimated at \$100 million at the end of 1955, were cut in half during 1956. This was partly because of a shift to currencies of countries not involved in the Suez crisis (notably to Swiss francs) and apparently also because of an increased use of sterling in trade with the Soviet Bloc. The \$300 million is equivalent to about 70 percent of the value of the recorded imports of China in 1956 from the Free World.

During 1957 there may be a reduction in the exchange earnings of Communist China from trade with the Free World because of reduced export capabilities resulting from poor harvests, reduced government procurement of agricultural products, and planning deficiencies.

- 5 -

S-E-C-R-E-T

S-E-C-R-E-T

Recently granted deferments in required exports to the USSR (the magnitude of which is as yet unknown) should, however, modify the immediate effects on Sino - Free World trade.

b. Reorientation of Trade.

If all CHINCOM nations except the US were to reduce the China differential trade controls to the level of the COCOM controls against the rest of the Soviet Bloc, it is most likely that these nations would increase both their export and import trade with Communist China, but not to an extent sufficient to result in a substantial reorientation in Chinese trade. Such a relaxation of trade controls, even if it included those of the US, would not greatly increase the ability of Communist China to secure commodities not now available through transshipment, but would permit an increase in exports to markets not now open and would reduce import costs on certain items.

It is estimated that savings in transport costs and premium payments resulting from a reduction of controls to the COCOM level by all but the US could amount to as much as \$35 million, thus permitting an increase of this amount in imports from the Free World. The transport savings would result from the use of Free World flag vessels for the carriage of formerly embargoed items (principally crude petroleum), thus avoiding the necessity of using more costly overland transport. Premium payments result from two factors: (1) additional costs incurred in clandestine procurement of restricted goods and (2) the decision of China to purchase rubber in higher-cost markets not controlled by CHINCOM as a means of exerting some counter pressure. If, in addition, ancillary shipping controls were abolished, permitting the carriage of refined POL products in Free World tankers, further savings of \$30 million annually might result. Should the US follow the other CHINCOM nations in reducing trade controls, Communist China might gain \$25 million annually in remittances from overseas Chinese as well as \$50 million a year from sales in the US.* Exchange earnings totaling \$50 million in addition might be derived from trade with Japan should China choose to drop present restrictions on trade with that country. China has been using the denial of coal and iron ore as a lever with which to pressure Japan into dropping the CHINCOM controls.

* See 4, p. 7, below, for a detailed analysis.

S-E-C-R-E-T

S-E-C-R-E-T

It is therefore estimated that as a consequence of the relaxation of the multilateral China differential trade controls, the capability of Communist China for importing from the Free World might be increased (depending upon the degree of relaxation) by between \$35 million and \$190 million. Because much of this increase in import capability would be caused by factors other than export earnings and because China already has a substantial export surplus in her balance of trade with the Free World, it is estimated that (barring significant reorientation of trade) concomitant increases in Chinese exports to the Free World would be somewhat smaller than this amount -- possibly no more than half as large.

4. Effects of the Continuation of Unilateral Controls by the US.

Until December 1950 the US was the major Free World trading partner of China. The imposition of US controls drastically reduced this trade, which fell from \$191 million in 1950 to \$47 million in 1951 and \$25 million in 1952 and has been negligible since. Thus US controls which impose a complete embargo on trade and financial activities with Communist China have caused a virtual cessation of commercial exchange between the two countries.

Because Communist China can obtain from other countries virtually all products produced in the US, the major effect of the continuation of the US embargo is the denial of a large market for Chinese handicraft and industrial raw materials. US imports of these goods from China amounted to \$120 million in 1948 and \$150 million in 1950. A substantial part of these goods included byproducts or utilized underemployed resources in their production, and the denial of markets represents a substantial net loss to the Chinese economy. On the other hand, the US has succeeded to some extent in finding substitutes or alternative sources of supply for such traditional Chinese exports as tung oil and hog bristles. Considering the reorientation of the exports of Communist China, the diversion of resources to the growing industrial sector, and the altered character of the US market, it is estimated that exports from China to the US as a unique market would probably be little more than \$50 million annually if controls were relaxed.

Overseas remittances to China may have exceeded \$100 million annually during the period before World War II, with perhaps more than half of this coming from the US. Price levels and incomes are now substantially higher than those of the 1930's, and it is possible

- 7 -

S-E-C-R-E-T

S-E-C-R-E-T

that remittances might, in the absence of controls, reach or even exceed those of prewar years. It is probable, however, that Americans of Chinese ancestry and American religious organizations are no longer interested in investing in mainland China properties. In addition, because of emigration and severance of family ties, the necessity for remittances to relatives has declined. Consequently, it is believed that if US controls were relaxed, US remittances would not greatly exceed \$25 million annually.

Thus it is estimated that the continuation of US unilateral controls is denying to Communist China approximately \$75 million annually in potential foreign exchange earnings. As an additional consequence of US controls, about \$100 million of Chinese assets in the US are blocked by the US Government.

- 8 -

S-E-C-R-E-T

S-E-C-R-E-T

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